IN THE

Supreme Court of the United States

October Term, 1943.

No.

The Raritan Company of Delaware, Inc.,
Petitioner,

v.

Commissioner of Internal Revenue,
Respondent.

BRIEF IN SUPPORT OF PETITION.

Opinions Below.

The opinion of the Board of Tax Appeals is printed at R. 3-11, and that of the Circuit Court of Appeals for the Third Circuit is printed at R. 18-20. Neither opinion has yet been officially reported.

Jurisdiction.

The judgment of the Circuit Court of Appeals was entered June 7, 1943 (R. 21). The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code as amended by the Act of February 13, 1925.

STATEMENT OF THE CASE, ETC.

A statement of the case and of the question presented already appears in the foregoing petition at pages 1-3, *supra.*

SPECIFICATION OF ERRORS TO BE URGED.

The Court below erred—

1. In failing to hold that the $25,000 payment by petitioner in 1937 was deductible under Section 355(b) of the Revenue Act of 1936 as amended, and that the decision of the Board of Tax Appeals should therefore be reversed.

2. In affirming the decision of the Board of Tax Appeals.

ARGUMENT.

Counsel are well aware that denial of a petition for certiorari in no sense imports approval of the decision below. But by the same token denial of the petition in such a case as the present could not be construed otherwise than as carte blanche to the circuit courts of appeals, if, as, and when they so please, to completely disregard and ignore the supposedly controlling rules of decision which have been announced by this Court in the course of its proper exercise of its Constitutional responsibilities. Let the record speak for itself.

LEGISLATIVE HISTORY.

The purpose and intent of a statutory provision have seldom been more clearly expressed in committee reports than was the case here. And the legislative history of a particular provision—both with respect to its original enactment in 1934 and its re-enactment in 1937—has seldom been more concisely and conveniently summarized than in the earlier and more sound decisions of this same court below.

We quote from the opinion of that court in *Commissioner* v. *Tennessee Co.,* 111 F. 2d. 678, at 680—

> "The raison d'etre of the instant statute is explained in general terms by its framers: 'Considerable hard-

ship has been avoided by permitting the deduction from the adjusted net income of a reasonable amount used or set aside to retire indebtedness incurred prior to January 1, 1934. This will substantially and properly relieve personally owned corporations which have outstanding bonds or other indebtedness that must be met from current earnings before distributions can be made.' Senate Rep. No. 558, 73rd Cong., 2d Sess., p. 15. [1934]

"The background for this action is described by Dr. Magill in his testimony before the House Ways and Means Committee in 1937: '* * * In 1934 the Congress adopted a new approach to this problem by the insertion in the law of section 351. The essence of this section was to define precisely the personal holding companies which would be subjected to the special surtaxes which the section imposed. It was not then known precisely how the section would operate, and accordingly **various cushions were adopted** to meet cases of anticipated hardship.' Hearings Before Committee on Ways & Means, House of Representatives, 75th Cong., 1st Sess., p. 27. [1937]

"Dr. Magill went on to recommend (on behalf of the joint Committee on Tax Evasion and Avoidance) that the retirement of indebtedness provision be repealed, because in many cases it afforded a means of preventing the distribution of earnings to stockholders contemplated by the personal holding company section. **The suggestion, however, did not persuade the legislators.** The Ways and Means Committee reported on the Revenue Act of 1937: '* * * While recognizing the reasons which impelled the joint committee to make this recommendation, your committee feels, from further study of the question, that the denial of this deduction would cause hardship in numerous cases where, due to the particular circumstances of the corporation, a dividend distribution cannot be made because of a necessity for legal reasons of using the earnings and profits to discharge the debts. Moreover, any loss of revenue caused by the continued allowance of this deduction cannot increase, since **indebtedness incurred after 1933** cannot be used as a basis for the deduction. **No corporation can be formed for the purpose of taking advantage of this deduction.** Furthermore, it is

> inevitable that the revenue loss must decrease as **pre-1934 debts** are retired. It is the hope of your committee that further study of the problem will disclose a solution whereby the deduction may be denied in the usual case but permitted in case its denial seems unjustifiable. * * *' H. Rep. No. 1546, 75th Cong., 1st Sess., pp. 12-13. [1937]
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> "The Senate Finance Committee not only agreed with their colleagues in the House, but also revised the measure so as to read: 'Amounts used or irrevocably set aside to pay or retire indebtedness of any kind incurred prior to January 1, 1934 etc.' 50 Stat. 813. In extenuation, they said: '* * * The insertion of the words "to pay" and "of any kind" are clarifying amendments to existing law, some controversy having arisen as to the intent of such law. * * *' S. Rep. No. 1242, 75th Cong., 1st Sess., p. 2." [1937]

Also from its opinion in *Commissioner* v. *Sun Pipe Line Co.*, 126 F. 2d. 888 at 890-891—

> "As is known, the primary purpose of Section 351 of the 1934 Act was to force the distribution of income of personal holding companies to their stockholders. The latter would then become liable to surtax on such income at rates which are higher than that imposed upon corporate income. But at the same time Congress wished to allow personal holding companies to make a reasonable accumulation for legitimate corporate purposes. A reserve created to pay off **existing obligations** was recognized as such a purpose and therefore a deduction from net income for these reserves was permitted. The appropriate Committees said: * * *"

After quoting again from the committee reports included in the above quotations from the *Tennessee Co.* case the opinion in the *Sun Pipe Line Co.* case continued at page 891—

> **"From these reports it is plain that the date, January 1, 1934, was selected to prevent incorporated pocketbooks from being formed after the passage of the Act** to take advange of its provisions. **'Indebtedness incurred' after that date were the words chosen rather than 'personal holding companies incorporated' after**

> **the date in order to prevent those corporations already in existence from building up fictitious debt structures** for which they might later set up reserves. So far as **existing debt structures** were concerned, Congress was resigned to the fact that it would be forced to permit tax free reserves to be accumulated for their liquidation. It was willing to let a deduction be taken by those corporations which fell within the Act to the extent of their **existing debt structure.** Congress was more interested in 'indebtedness' as an amount rather than as a reference to specific contracts. In those cases where the deduction could have been taken but was not, there appears to have been no intent to prevent the deduction subsequent to a refund" (i. e., a refunding of the debt).

The legislative history as developed in the above opinions confirms that Congress was thinking throughout in terms of the indebtedness itself, and that its only thought was to prevent the formation of new corporations or the erection of new debt structures to take advantage of the deduction provision. In other words, it was putting an end to the creation of any additional "incorporated pocketbooks."

The retirement of the "pre-1934 debt" in the present case was on the other hand squarely within the spirit as well as the letter of the "cushion" which Congress sought to provide. After this tax had already been in effect for three years Congress reappraised this whole situation when it had under consideration the Revenue Act of 1937 which governs the particular year here in question. Its specific rejection in 1937 of Dr. Magill's suggestion for repeal of this indebtedness deduction at the same time that it increased this particular tax rate from a relatively mild 18 per cent-48 per cent graduated scale (on the excess over $2,000) to a punitive 75 per cent confirms its very definite intent that, where the income of a corporation such as this petitioner was the only source for liquidation of indebtedness which antedated 1934, that source was not to be destroyed by the tax.

And conversely, there can be found here not the slightest resemblance to any of the evils which Congress sought to prevent. The debt, the taxpayer, and the taxpayer's substantial interest in the debt, all co-existed prior to 1934. The taxpayer's net worth in the period prior to 1934 had reflected a reduction to the full extent of this identical indebtedness just as much as it continued to reflect such a reduction subsequent to the liquidation of its subsidiary in 1936. There was no new corporation or fictitious debt structure or any other subterfuge. The whole transaction was one which had already developed in the normal course of business (R. 4-6), and indeed the respondent himself has formally found and declared that the subsequent 1936 step by which the taxpayer's previously indirect interest in this indebtedness became a direct one was not directed toward any avoidance of income taxes (R. 6).

Controlling Decisions of This Court.

In the present case the court below has, in direct conflict with its own opinion in the *Sun Pipe Line* case (pages 10-11, *supra*), held that the term "incurred" as used in this provision can have no other connotation than that the debt must in the strictest and most technical legal sense have been contracted by this particular taxpayer prior to the critical date. That the wording is by no means so clear and unambiguous is demonstrated by cases such as *Bank of Indian Territory* v. *Eckles*, 19 Okla. 159, 91 P. 695, 697, where in construing an Act of Congress which related to indebtedness "contracted or incurred" prior to a certain time, it was held that the two quoted words were not synonymous, and that "incurred" may also mean "brought on, occasioned, or caused." But even if the wording was apparently clear and unambiguous its present opinion would still run counter to the controlling principle so clearly announced by this Court in two recent cases which effectively implement the more general rule of the *Ozawa* case already quoted from in our petition at page 4, *supra*.

In *United States* v. *American Trucking Co.*, 310 U. S. 534, 543, this Court summarized the prevailing rule of statutory construction in a single but copiously annotated paragraph from which we quote in part—

> "Frequently, however, even when the plain meaning did not produce absurd results but merely an unreasonable one 'plainly at variance with the policy of the legislation as a whole' this Court has followed that purpose, rather than the literal words. **When aid to construction of the meaning of words, as used in the statute, is available, there certainly can be no 'rule of law' which forbids its use, however clear the words may appear on 'superficial examination.'** * * * Obviously there is danger that the courts' conclusion as to legislative purpose will be unconsciously influenced by the judges' own views or by factors not considered by the enacting body. A lively appreciation of the danger is the best assurance of escape from its threat but hardly justifies an acceptance of a literal interpretation dogma which withholds from the courts available information for reaching a correct conclusion. Emphasis should be laid, too, upon the necessity for appraisal of the purposes as a whole of Congress in analyzing the meaning of clauses or sections of general acts. **A few words of general connotation appearing in the text of statutes should not be given a wide meaning, contrary to a settled policy, 'excepting as a different purpose is plainly shown'."**

Even more recently, in *Harrison* v. *Northern Trust Co.*, 317 U. S. 476, 479, this Court reiterated and applied that rule in an estate tax case which presented an issue strikingly similar to that in the case at bar. There as here the lower court had seized upon and overemphasized a single qualifying expression. But to continue in the words of this Court at page 479—

> "In so doing the court below refused to examine the legislative history of § 807 on the ground that the section was unambiguous.
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> **"But words are inexact tools at best and for that reason there is wisely no rule of law forbidding resort to**

> **explanatory legislative history no matter how 'clear the words may appear on "superficial examination".'** United States v. American Trucking Assos., 310 U. S. 534, 543, 544. See also United States v. Dickerson, 310 U. S. 554, 562. So, accepting the Circuit Court's interpretation of Illinois law as to the incidence of the tax, we think **it should have considered the legislative history of §807 to determine in just what sense Congress used the words 'payable out of.' The committee reports on §807 demonstrate that it was intended as** 'a legislative reversal of the decision' in Edwards v. Slocum, 264 U. S. 61 supra (H. Rep. No. 708, 72d Cong. 1st Sess. p. 50), and that Congress used the words 'payable out of' in the sense of 'diminished or reduced by' the payment of the tax. Thus the House Report states: * * *"

As already indicated, both of these cases were quoted from at even greater length in our brief below. Yet neither they nor the principle which they announce were even referred to in the opinion. The reason is readily apparent. When read in connection with the legislative history already so familiar to that court it is obvious that the decision sought to be sustained in its opinion in the instant case could not possibly be reconciled to the principle laid down in those cases. It was the duty of the court below to apply that rule irrespective of whether it liked or disliked the particular result to which it unavoidably led in a particular case, and we submit that the court's deliberate failure to do so is a proper subject for the exercise of the supervisory jurisdiction of this Court. Especially so, where as here its ignoring that principle so obviously led to a concrete realization of the very danger so expressly anticipated by this Court in the above quotation from the *American Trucking Co.* case when it expressly stressed the necessity of avoiding this "danger that the court's conclusion as to legislative purpose will be unconsciously influenced by the judges' own views or by factors not considered by the enacting body."

CONFLICTING CIRCUIT COURT OF APPEALS DECISIONS.

The decision below squarely conflicts with that of the Circuit Court of Appeals for the Second Circuit in the very recent case of *Commissioner* v. *Grant Trading Co.*, 135 F. 2d. 358. The Treasury Department had taken the position that this deduction is allowable only when there had been no change of any sort in respect to the parties since prior to 1934. Indeed it had even gone so far as to reduce that position to a formal regulation which in case of the giving of a new promise or other change in the form of the indebtedness permitted the deductions here in question only where "the relationship of debtor and creditor continues between the taxpayer and his creditor." In the *Grant* case, as in so many other cases, the pre-1934 indebtedness to a bank and a business corporation had been subsequently refinanced in their entirety through a loan from another and different bank. The Commissioner of Internal Revenue disallowed the deduction of a 1938 payment on the indebtedness which had not been technically contracted with the second bank until after 1934, but the Tax Court reversed his action, and the Circuit Court of Appeals affirmed the decision of the Tax Court, ruling at page 359—

> "The case is here on the Commissioner's petition to review. He contends that the Treasury Regulation is controlling and that, accordingly, there was no pre-1934 debt in existence after 1937 when the taxpayer paid the debts owing to the Public National Bank & Trust Company and the Phillips-Jones Corporation. The Tax Court was correct. **Having in mind the purpose of the statute, as shown by its legislative history**, we agree with the opinion in Commissioner v. Sun Pipe Line Co., 3 Cir., 126 F. 2d 888, with the modification suggested in the concurring opinion therein of Judge Jones and as reaffirmed in B. D. Phillips, Inc., v. Commissioner, 3 Cir., 134 F. 2d 73, decided February 17, 1943. For the reasons stated in those opinions, **the Treasury Regulation must be disregarded because it is completely at variance with the Congressional purpose** and cannot be said to have been subsequently adopted by Congress."

To substantially the same effect are the *Sun Pipe Line* and *Phillips* decisions of the Circuit Court of Appeals for the Third Circuit cited in the above opinion, as well as its decision in *Commissioner* v. *Piermont Corp.,* 126 F. 2d. 888.

The present decision simply cannot be reconciled with any of those cases which so properly construe the statute in accordance with "the Congressional purpose" as "shown by its legislative history." Indeed the sharpness of the conflict is clearly shown by the fact that in the present case the Revenue Agent's Report of December 31, 1939,* expressly cited "T. D. 4477, C. B. 1937-2, p. 196," a regulation for the earlier year 1937 containing word for word the identically same provision which was subsequently held invalid in the *Grant* case. The distinction sought to be drawn in the *ipse dixit* of the court below in which it contents itself with merely declining what it terms an invitation to apply the same ruling to the other end of the debtor-creditor relation (R. 20) finds no support whatever in the legislative history. On the contrary even a cursory examination of the legislative history shows that—to borrow a phrase from the opinion in the *Grant* case—it would be even "more completely at variance with the Congressional purpose" to deny the deduction where as here the essential continuity of this debt (secured as it was by the same collateral and evidenced by the same note since long prior to 1934) was for the purposes of this legislation a far more dominant and controlling factor than any mere technical change in the legal makeup of the debtor group unaccompanied by any substantial change in its economic relation to the indebtedness.

The *Grant* decision in the Second Circuit, like the *Sun Pipe Line* and *Phillips* cases which it cites from the court below, all apply the legislative purpose as the controlling

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*Note.—This report was not introduced in evidence but was referred to and its recommendations adopted without change in the statutory deficiency letter which is attached as Exhibit A to the original petition to the Board of Tax Appeals and which is part of the unprinted record lodged with the Clerk of this Court.

test. That purpose has been fully developed at pages 8-12, *supra*. In the *Sun Pipe Line* case, for example, the record as it appears in the findings of facts reported at 42 B. T. A. 1413, 1414, shows that subsequent to January 1, 1934, a $4,000,000 issue of "3½ per cent serial" debentures was sold in its entirety to a group of "four banking institutions and one life insurance company," and that its only relation to any pre-1934 indebtedness was that its proceeds were used in part to pay off a $3,500,000 issue of "5 per cent sinking fund gold" debentures which about 1930 had been sold to "many individuals." Having in mind the legislative history and the legislative purpose, the decision below denying the deduction in a case of no substantial change as summarized in the concluding sentence of the immediately preceding paragraph of this brief cannot possibly be reconciled with its allowance in the *Grant, Sun Pipe Line,* and similar cases.

Respectfully submitted,

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